

Internal Revenue Service
memorandum

CC:TL

Br4:GJDickey

date:

JAN 15 1986

to:

District Counsel, St. Louis MW:STL

from:

Acting Director, Tax Litigation CC:TL

subject:

This is in response to your request for technical advice in the subject case.

ISSUE

In computing its [REDACTED] I.R.C. § 56 corporate minimum tax, did the taxpayer properly reduce the figures it used under the Treas. Reg. § 1.57-1(i)(2)(i) alternative formula for determining its I.R.C. § 57(a)(9)(B) capital gain tax preference amount, by taking into account tax credits? 0057.01-08.

CONCLUSION

As indicated in your request for technical advice, there appears to be no legal authority to support the taxpayer's position as to this issue. Neither the statute, its legislative history, the applicable Treasury Regulations, case law, nor the potentially applicable G.C.M.'s, O.M.'s, private letter rulings, or revenue rulings support the taxpayer's contention that it may reduce its figures for determining I.R.C. § 57(a)(9)(B) capital gain tax preference by certain tax credit amounts. Accordingly, we conclude that the taxpayer may not do so for tax year [REDACTED]. This conclusion has been coordinated with the Legislation and Regulations Division, CC:LR.

FACTS

The subject case involves a dispute over taxable year [REDACTED]. In determining its I.R.C. § 56 minimum tax, the corporate taxpayer used the alternative formula set forth under Treas. Reg. § 1.57-1(i)(2)(i) to compute its capital gain tax preference amount. Such computation involves subtraction of the I.R.C. § 1201(a) alternative tax from the I.R.C. § 11 tax and dividing the difference by .46. Before doing this, however, the taxpayer reduced its I.R.C. § 11 tax liability of \$ [REDACTED] to \$ [REDACTED] by subtracting \$ [REDACTED] in investment tax credits and \$ [REDACTED] in jobs credit. The taxpayer then reduced its \$ [REDACTED] of I.R.C. § 1201(a) alternative tax to \$ [REDACTED] by subtracting \$ [REDACTED] in investment tax credit and [REDACTED] in jobs credit.

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By subtracting \$ [REDACTED] of investment tax credit less in reaching its I.R.C. § 1201(a) alternative tax than it subtracted from its section 11 tax, the taxpayer seeks to reduce its total capital gains tax preference by \$ [REDACTED]. The reason for this differential is that in [REDACTED] the investment tax credit was subject to a limitation based on the taxpayer's liability for tax. Since the taxpayer had a lower limit when its tax was computed under section 1201(a) than under section 11, less of the credit was available .

DISCUSSION

The corporate minimum tax imposed under I.R.C. § 56 is equal to 15 percent of the amount by which the taxpayer's total tax preference exceeds the greater of its regular tax deduction or \$10,000.00. Tax preference items are set forth under I.R.C. § 57. The corporate capital gain preference amount is specifically addressed at I.R.C. § 57(a)(9)(B). It is the computation of this amount which is at issue in the subject case. The statutory formula for this computation is:

$$\text{net capital gain} \times \frac{(\text{highest rate specified in § 11(b)}) - (\$1201(a) \text{ alternative tax rate})}{(\text{highest rate specified in § 11(b)})}$$

or, as would be applicable in this case:

$$\$ [REDACTED] \times \frac{.46 - .28}{.46} \text{ or } \$ [REDACTED].$$

Nevertheless, because the statutory formula overstates the tax benefit in certain instances, the Treasury Department implemented Treas. Reg. § 1.57-1(i)(2)(i), which provides an alternative formula:

$$\frac{(\text{section 11 tax (without regard to § 1201(a)))} - (\text{tax actually imposed})}{(\text{normal tax rate})^*}$$

which if strictly applied would yield the same amount as the statutory formula:

$$\frac{\$ [REDACTED] - [REDACTED]}{.46} \text{ or } \$ [REDACTED].$$

The sole issue under consideration is whether the taxpayer may reduce its figures by credits. We have found little to support the taxpayer's contention that this may be done. Contrariwise, the clear weight of authority leads us to conclude that credits are not part of the section 11(b) and section

*Corporate surtax was eliminated by P.L. 95-600 in 1978.

1201(a) tax computations and were not intended by the statute, nor may they be interpreted to be, included in determination of corporate capital gain preference.

In this regard, we fully agree with the "[r]espondent's position" as stated in the request for technical advice. The taxpayer has not followed the statutory formula and strives to read into the regulatory formula a "remedy" which simply does not exist. The statutory formula is not complex; and if applied as drafted will generally result in a true measure of capital gain preference. Further, it cannot reasonably be interpreted as allowing for factoring out tax credit items. The formula utilizes rates of tax, not amounts of tax. Subtraction of credit amounts from tax rates would make no mathematical or intuitive sense. Accordingly, we do not think it can be gainsaid that Congress had no intention to allow for factoring out tax credits under the statute.

The regulatory formula is merely a refinement of the statutory formula and is wholly consonant with Congressional intent, reflecting the Treasury Department's efforts to eliminate, to the maximum extent allowable under the statute, potential inaccuracy in those situations where not all of a corporation's capital gain is taxed at the highest rate. The Treasury is without power to do more if its regulations are to remain consistent with the statute.

If you have any further questions or need additional assistance in this matter, please contact Gordon J. Dickey of this office at FTS 566-3345.

MARLENE GROSS
Acting Director

(Signed) Henry G. Salamy

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